

31 March 2005

Baron Furstenburg
National Treasury

Dear Baron

Comments in respect of your discussion paper on Retirement Fund Reform

Thank you for inviting us to comment on your December 2004 discussion paper entitled Retirement Fund Reform. We welcome National Treasury's efforts in this regard, and we congratulate you on a document that is not only well written, but is also clearly based on sound and consistent principles.

Overall we believe that the proposals contained in the paper will be beneficial for the entire savings industry. Given this, we share your hope that the declining trend in our national savings rate will be reversed. However, our concern is that inflexible implementation of your principles may discourage investors from being part of the retirement funding net, discouraging their overall savings levels.

Our comments are therefore centred on a balanced implementation of your principles, specifically within individual retirement funds. Overall we would advocate just enough freedom in order to ensure that investors are still attracted to the retirement funding net. Although the key focus of our comments is on individual retirement funds and investment regulation, we have taken the liberty of also commenting on two aspects of the proposed National Savings Fund.

1. Individual Retirement Funds

1.1 Although the paper advocates some sort of capping of ancillary benefits, it appears to favour "packaged" retirement funds over "investment-only" retirement funds. We would argue that most sophisticated individuals will cater separately for their life and disability cover. We believe that these individuals will not be attracted to "packaged" individual retirement funds where they would be obliged to purchase life and disability cover. We therefore propose that there be no restriction on offering investment-only retirement funds, especially investment-only individual retirement funds.

1.2 We understand the need for limiting member choice within occupational retirement funds, where trustees may struggle to ensure that proper advice is being given. However, we believe that sophisticated individuals will not be attracted to an individual retirement fund that offers only four or five choices. Fortunately the risk of insufficient advice is far lower within an individual retirement fund, where most providers insist on the involvement of a qualified financial advisor. We therefore propose that there be no restriction on the number of member-choice options within an individual retirement fund.

1.3 One of the paper's recurring themes is that of compulsory preservation and annuitisation. We agree that this is probably a necessary step in order to deal with the serious problem of leakage. Unfortunately this is the step that we believe is most likely to discourage sophisticated individuals from joining the retirement funding net. We believe however that membership by these individuals can be encouraged by offering more attractive annuitisation options – in the form of flexible annuities (living annuities). We therefore propose that living annuities be recognised as legitimate annuitisation vehicles, for both retirement and death benefits. Although we believe that the introduction of FAIS will limit any mis-selling of these annuities, National Treasury might consider imposing a minimum premium of say R500,000 on living annuities, in order to ensure that they are accessed only by sophisticated individuals.

1.4 Continuing with the theme of compulsory preservation and annuitisation, we recognise the current inconsistency between Retirement Annuities and occupational retirement funds. The latter currently allow for taxable early-withdrawal, while the former involve compulsory preservation to age 55. There are also differences in the maximum contributions practically allowed within each of these types of funds. We believe that your principled approach will remove such inconsistencies, and we propose that you make it clear that all retirement funds will be treated equally when it comes to contributions, preservation and annuitisation, whether they be RA funds or other types of individual retirement funds.

1.5 The paper proposes that any type of upfront commission be disallowed in respect of retirement funds. The paper is silent however on the payment of ongoing advisor fees, other than to suggest that fees in general should preferably not be regulated. In the light of FAIS and the proposed Regulation 28, many providers of individual retirement funds insist on the involvement of a qualified financial advisor in order to give ongoing advice regarding investment choices and other fund-related decisions. These advisors are usually independent of the provider, and are often reliant on annual advisor fees from the provider. We therefore propose that ongoing advisor fees be allowed in respect of retirement funds, especially individual retirement funds. National Treasury might consider imposing compulsory transparency (e.g. via the regulator publishing comparative fees) as well as a maximum advisor fee of say 1% of assets per annum, in order to avoid any abuse of this feature.

2. Investment Regulation

2.1 As noted in 1.2, we understand the need for limiting member choice within occupational retirement funds. As pointed out in the paper, member choice occupational funds seldom allow for personalised member advice to be given. In addition, member-choice funds are more expensive to administer, which leads to cost impacts on all members, including those members who decide not to exercise choice. Unfortunately, limiting choices to four or five options does not reduce these short-comings. Members would still make inappropriate choices, and costs would still be increased for all members. As an alternative, we would propose that occupational funds be prohibited outright from offering member choice within the fund. Instead, employers could endorse a separate individual retirement fund with full member choice. Employees preferring member-choice could then opt-out of the occupational fund and rather join the individual fund. Individual funds are likely to be larger, allowing for greater scale benefits and lower costs. Costs are still likely to be higher than within the no-choice fund, but at least this affects only those members who have opted for member choice.

2.2 The paper mentions a requirement for the regulator to suggest benchmarks against which the performance of asset manager may be assessed. We would propose that this list of benchmarks rather be a list of simple performance targets, with appropriate measurement periods. Given that benchmarks are a complex topic – with new benchmarks published regularly – we believe that consultants and asset managers are better positioned to select these, maybe in light of the regulator's suggested targets. For example, the regulator might suggest a target of “inflation plus 5% pa measured over rolling five-year periods”. In the light of this, the asset manager or consultant may decide to use a composite benchmark consisting of the ALSI and the ALBI, measured over rolling three-year periods. We would propose further that the regulator's list contain only “inflation plus” targets, each with appropriate measurement periods, as agreed with relevant industry bodies.

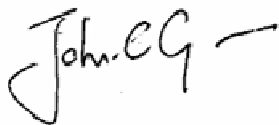
3. The proposed National Savings Fund

3.1 We support this initiative, while recognising that much of the detail is still outstanding. Given our experience in offering similar large-scale administration services, we can confirm that cost-control will be one of this fund's greatest challenges. The easiest approach may be to simply lay down a set of standards which a fund must meet in order to qualify for National Savings Fund status. E.g. National Treasury may decide that all unit trust funds within the Prudential sector qualify as National Savings funds. An alternative approach would be to invite tenders for centralised administration from the private sector, e.g. from the linked investment service providers. This may be a cheaper option ultimately, given the associated bulking, while still offering access to a range of private sector managers. A third option would be to centralise both the administration and the asset management of the fund, by inviting tenders for both services from the private sector. The challenge here would be the inevitable trade-off between cost and potential returns, e.g. tenders for passive management are likely to be the cheapest but not necessarily the best for members.

3.2 We understand the need for encouraged preservation within the National Savings Fund, while affording the needy with some flexibility. But we would caution against the proposed terminal bonuses, or any discretionary bonuses for that matter. Insurance industry experience suggests that discretionary bonuses are often disputed. In addition, awarding terminal bonuses on irregular contributions will involve calculations that may be too complex for this market. As an alternative, we would propose a softer form of preservation and annuitisation for the National Savings Fund – one that we believe will not discourage participation by less sophisticated individuals. We propose that members be allowed to make withdrawals from the fund at any time, but that withdrawals in any calendar year be limited to say 20% of their fund balance at the end of the previous year. This would allow members far greater flexibility in the case of temporary unemployment, terminal illness, or early retirement. It would also ensure a strong degree of annuitisation after normal retirement.

Once again we thank you for allowing us to comment on the discussion paper, and we wish you all the best in the challenging task of collating and addressing the many submissions you are bound to receive. Please be assured of our support and feel free to call on us should you require any further assistance in this process.

Yours sincerely

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John Green
Investec Asset Management

A handwritten signature in black ink that appears to read "Johan Schreuder" with a long horizontal line extending to the right.

Johan Schreuder
Investec Asset Management